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Supreme Court of the United States

OCTOBER TERM, 1942
No. 835

UNITED SHIPYARDS, INC.,

Petitioner,

—v.—

JANE M. HOEY, as Executrix of the Estate of
James J. Hoey, Deceased,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF THEREON

JOHN F. CONDON, JR.,
Solicitor for Petitioner,
UNITED SHIPYARDS, INC.



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*To the Honorable Chief Justice and Associate Justices of the
Supreme Court of the United States:*

Petitioner, United Shipyards, Inc., a dissolved New York corporation, prays that a writ of certiorari issue to review the decree of the United States Circuit Court of Appeals for the Second Circuit entered the 18th day of December, 1942, reversing a decree of the District Court of the United States for the Southern District of New York. A certified transcript of the record of the case, including the proceedings in said Circuit Court of Appeals is furnished herewith in compliance with the Rules of this Court.

Summary and Statement.

Petitioner brought a civil action alleging two causes of action. The first cause of action claimed recovery of capital

stock tax erroneously collected for the capital stock tax year 1936 in the amount of \$10,100 (R. 2); the second cause of action claimed recovery of the sum of \$5,190 erroneously collected for the capital stock tax year 1937 (R. 4).

The case was tried without a jury before Judge Bondy in the United States District Court for the Southern District of New York, and judgment was awarded to petitioner on both causes of action (pp. 11, 13). Subsequently, defendant, James J. Hoey, Collector of Internal Revenue, Second District, New York, died, and the executrix of his estate was substituted by order of the Court and certificate of probable cause was issued on February 3, 1942.

Respondent appealed to the United States Circuit Court of Appeals, Second Circuit from the judgment entered in the District Court on the 28th day of January 1942. Respondent abandoned the appeal from that part of the judgment covering the second cause of action (R. 40). Accordingly, the decree of the Circuit Court of Appeals pertains only to the first cause of action. The appeal was argued October 22, 1942, and a decision was rendered November 30, 1942. A copy of the opinion and decision of the Circuit Court of Appeals appears in the record (pp. 33-38).

Petitioner, a New York corporation, was organized under the name of United Dry Docks, Incorporated in 1928 for the purpose of building and repairing ships. On July 23, 1934, a petition for reorganization of petitioner was filed in the United States District Court for the Southern District of New York under Section 77B of the Bankruptcy Act (R. 33). The District Court approved the petition and entered an order, subsequently made permanent, continuing petitioner as a debtor in possession of its property and estate subject to the control and supervision of the Court in accordance with the applicable provisions of the National Bankruptcy Act (R. 19). During the course of the proceeding, a reorganization was effected wherein and whereby

the name of petitioner was changed to United Shipyards, Inc. Petitioner was in reorganization under Section 77B of the Bankruptcy Act until March 5, 1937 (R. 20).

Capital stock tax in the amount of \$10,000 and \$100 interest for the capital stock tax year 1936 was assessed and collected. Petitioner's claim for refund was denied, and the suit referred to herein was commenced (R. 21).

This case arises under Section 105(a) of the Revenue Act of 1935 (49 Stat. 1017), as amended by Section 401(a) of the Revenue Act of 1936 (49 Stat. 1733), providing in substance that for each year ending June 30th, there is imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year, an excise tax of \$1.00 for each \$1,000 of adjusted declared value of its capital stock.

Regulations 64, Article 35 so far as pertinent is quoted as follows:

"If during any entire year ending June 30th all of the property of a corporation is in the hands of such public official (i.e. a receiver or a trustee in bankruptcy or is in the custody of a federal or state officer pending the appointment of a receiver or trustee in bankruptcy) the corporation is not subject to the tax for such year * * *."

Respondent, both in the Regulations and in the brief filed in the Circuit Court of Appeals, conceded, as the Regulations above quoted state, that if a receiver or trustee in bankruptcy has custody of the corporate assets during the entire capital stock tax year, the corporation is not subject to capital stock tax. Respondent takes the position that there is a distinction for capital stock tax purposes between a receiver or trustee in bankruptcy or custody of a federal or state officer pending the appointment of a receiver or

trustee in bankruptcy, and a debtor in possession under a 77B proceeding.

Decision of the District Court.

AS TO THE FIRST CAUSE OF ACTION:

The decision of the District Court in favor of petitioner with respect to the first cause of action (R. 11-13) holds in substance that "a business carried on by a debtor corporation continued in possession under Section 77B of the Bankruptcy Act, 11 U. S. C. A. 207(c)(11) is carried on by the debtor acting as a trustee or receiver", citing various cases, including, *In re: Walker*, 93 F. (2d) 281; *In re: Wil-Low Cafeterias*, 111 F. (2d) 83, and stated,

"The capital stock tax for the year ending June 30, 1936 was, therefore, erroneously collected from the taxpayer" (R. 12).

***Decision of the United States Circuit Court of Appeals,
Second Circuit.***

The decision of the United States Circuit Court of Appeals was handed down November 30, 1942 (R. 33-38), and deals only with the first cause of action alleged in the complaint, although it states at the end thereof "judgment reversed". The order for mandate provided that the judgment was "reversed so far as it relates to the first cause of action, with costs" (R. 40). The opinion states that the decisions in the cases of *In re: Walker* cited *supra* and *In re: Martin Custom-Made Tires*, 108 F. (2d) 172 were not "in point", and that "a debtor is not a receiver or trustee"; and stated, "For the corporation debtor is still carrying on or doing business although the manner in which it can operate is restricted by trustee obligations imposed by the

Bankruptcy Act". The opinion states, "The plain truth is that it was still doing its business but subject to limitations under the Bankruptcy Act restricting the purposes for which, and the manner in which, it could conduct that business."

Petition for Rehearing.

Upon receipt of the decision of the Circuit Court, petitioner made petition for rehearing which was denied December 18, 1942 (R. 39).

Jurisdiction.

The jurisdiction of this Court to issue the writ of certiorari applied for rests upon Title 28 of the U. S. Code Annotated, Section 347.

Questions Involved.

First: Whether petitioner as a debtor in possession in reorganization pursuant to Section 77B of the National Bankruptcy Act is liable as a corporation for capital stock tax for the year ending June 30, 1936.

Second: Whether there is any distinction for capital stock tax purposes for the capital stock tax year 1936 between a debtor in possession under Section 77B of the National Bankruptcy Act and a corporation in receivership pursuant to Section 77B of the National Bankruptcy Act where the Court in its discretion appoints trustees other than the debtor in possession.

Reasons Relied on for the Allowance of the Writ.

(1) The United States Circuit Court of Appeals for the Second Circuit erred in deciding that the status of a debtor

in possession under Section 77B of the Bankruptcy Act for capital stock tax purposes for the capital stock tax year 1936 is different from the status of a corporation in reorganization under Section 77B of the Bankruptcy Act for the year 1936 where the Court in its discretion appoints trustees other than the debtor in possession. Under the Regulations, there is no capital stock tax liability where a Trustee is appointed, therefore there is none where the Debtor is left in possession.

(2) The decision of the United States Circuit Court of Appeals misinterprets the meaning and intention of the applicable provisions of Section 77B of the Bankruptcy Act and the tax law and regulations with respect to capital stock tax for the year 1936 in that no capital stock tax can properly be assessed against any debtor in a 77B proceeding. In a proceeding under Section 77B of the Bankruptcy Act, the bankruptcy court is administering a trust fund for the benefit of all concerned and there is no capital stock or stockholders as such. There is a complete ouster of corporate management and control.

(3) The questions here involved are of general importance and are questions of substance relating to the construction of a statute of the United States. An important question of federal tax law has not been but should be decided by this Court, i.e. whether a debtor in possession under Section 77B of the Bankruptcy Act is subject to Capital Stock Tax.

(4) The decision of the United States Circuit Court of Appeals in this case is in conflict with the principles enunciated in the decision of this Court in *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106. We quote from the opinion of this Court at pages 125-130 as follows:

"Once the property is in the hands of the court private rights as respects that res are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by the Congress. * * * The court acquires 'exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section' (Sec. 77B(a)). The court need not keep the debtor in possession but may substitute for the old management a trustee; or if the old management is retained it operates the business 'subject at all times to the control of the judge, and to such limitations, restrictions, terms and conditions as the judge may from time to time impose and prescribe.' Thus, while the property remains in the hands of the court, as it does until dismissal or final decree on confirmation, the debtor, though left in possession by the judge, does not operate it, as it did before the filing of the petition, unfettered and without restraint. The control of the court is then pervasive. Furthermore, stockholders and other junior interests may be excluded from any plan of reorganization if the court finds that the debtor is insolvent. *Re 620 Church Street Bldg. Corp.*, 299 U. S. 24, 81 L. ed. 16, 57 S. Ct. 88, 32 Am. Bankr. Rep. (N. S.) 185. * * *

"The right to remain in unmolested dominion and control over the property was necessarily waived or abandoned on invoking the jurisdiction of the Federal courts in these proceedings. When that jurisdiction attached, the court rather than the stockholders was in control with all of the powers and duties which that entailed under §77B."

"* * * As a result of the filing of the petition in this case, the court, not the stockholders, acquired exclusive dominion and control over the estate."

The following quoted statement from the opinion of the United States Circuit Court of Appeals in this case appears to be in conflict with the statement of this Court in the decision above quoted:

"A debtor company in possession is not a receiver or trustee. * * * For the corporation debtor is still carrying on or doing business, although the manner in which it can operate is restricted by trustee obligations imposed by the Bankruptcy Act. * * * The plain truth is that it was still doing its business, but subject to limitations, under the Bankruptcy Act, restricting the purposes for which, and the manner in which, it could conduct that business."

(5) There is lack of uniformity in the decisions of the lower Courts as to the taxability for capital stock tax purposes of a debtor in possession. In the case of *Colorado Fuel & Iron Company v. Nicholas*, 28 F. Supp. 448, decided in the United States District Court for the District of Colorado, affd. 112 F. (2d) 858, Tenth Circuit, the Government asserted that there was a distinction between a debtor in possession and a trustee. With respect to this contention, the District Judge stated, 28 F. Supp. 448 at page 450, "I doubt if the distinction is a good one but be that as it may, he supports the view that where the Court is operating the property and not the corporation, the latter is not liable for the tax."

(6) The decision of the United States Circuit Court of Appeals, Second Circuit, in principle is in conflict with the decisions of that Court in the following cases:

In re: Walker, 93 F. (2d) 281;

In re: Martin Custom-Made Tires, 108 F. (2d) 172.

In *In re Walker* (C. C. A. 2d, 1937) 93 F. (2d) 281, at page 283, the Court stated:

"* * * the purpose of subdivision (c) (11), 11 U. S. C. A. §207 (c) (11), is certainly that the debtor shall be

in fact a trustee, if the judge thinks best; otherwise an independent trustee is inevitable, since the court must in some fashion control the property."

In *In re Martin Custom-Made Tires Corp.* (C. C. A. 2d, 1939), 108 F. (2d) 172, at page 173, the Court stated:

"The attempted distinction between the powers of a debtor in possession and the rights of a trustee in bankruptcy is unreal. A debtor in possession holds its powers in trust for the benefit of the creditors."

Under the foregoing decisions of the Circuit Court of Appeals, Second Circuit, if a debtor in possession holds its powers in trust for the benefit of creditors, the debtor in possession is a trustee, and therefore, exempt from Capital Stock Tax under Regulations 64 Article 35 cited *supra*.

For the reasons more fully set forth in the annexed brief, petitioner avers that the decision of the Circuit Court of Appeals for the Second Circuit is erroneous.

WHEREFORE, petitioner prays the allowance of a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit in this cause, there entitled *United Shipyards, Inc., Plaintiff-Appellee, v. Jane M. Hoey, as Executrix of the Estate of James J. Hoey, deceased, Defendant-Appellant*, No. 76, that said cause may be reviewed and determined by this Court and that the judgment of the United States Circuit Court of Appeals for the Second Circuit may be reversed and set aside, and for such further relief and remedy in the premises as this Court may deem meet and proper.

UNITED SHIPYARDS, INC.

JOHN F. CONDON, JR.,
Solicitor for Petitioner.

Dated, New York, N. Y., March 15, 1943.